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World economic situation and prospects as of mid-2017*

Summary

Global economic growth has strengthened in the past six months, in line with the forecasts reported in the *World Economic Situation and Prospects 2017*. Helped by a moderate recovery in trade and investment, world gross product is expected to expand by 2.7 per cent in 2017 and 2.9 per cent in 2018. While this marks a notable acceleration compared with 2016, growth in many regions remains below the levels needed for rapid progress towards achieving the Sustainable Development Goals.

Underpinning the global economic recovery is firmer growth in many developed economies. Prospects for many economies in transition have also strengthened, while East and South Asia remain the world's most dynamic regions. However, the outlook for some developing regions has deteriorated since January. Prospects for Africa, in particular, raise concerns. Gross domestic product per capita declined in Central, Southern and West Africa in 2016, with negligible per capita growth anticipated in 2017-2018. Indeed, for some of the world's poorest countries, downward revisions to forecasts raise particular concerns for the implementation of the 2030 Agenda for Sustainable Development.

A rebound in confidence and more upbeat economic sentiment suggest that perceptions of risks have diminished in recent months. Nonetheless, this optimism has not yet translated into significant gains in the real economy, and a high degree of uncertainty in the international policy environment continues to cloud the outlook. In many emerging economies, the corporate sector remains vulnerable to sudden changes in financial conditions and destabilizing capital outflows. There is a significant risk that the expectations underpinning buoyant global economic sentiment may be disappointed, leading to a sharp reversal of confidence.

As global commitments to deeper international policy coordination appear to be waning, renewed efforts are needed to ensure progress in key areas of global importance, including aligning the multilateral trading system with the 2030 Agenda for Sustainable Development; expanding international public finance and official development aid; supporting climate finance and clean technology transfer; and addressing the challenges posed by large movements of refugees and migrants.

* The present document updates *World Economic Situation and Prospects 2017* (United Nations publication, Sales No. E.17.II.C.2), released in January 2017.

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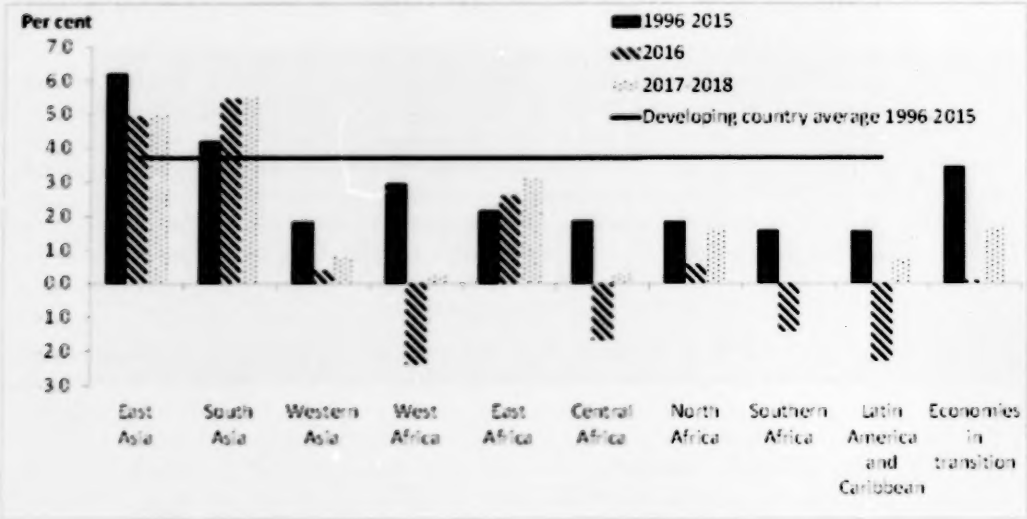
I. Global macroeconomic trends

Global economic prospects

1. A modest strengthening of global economic activity became evident towards the end of 2016 and continued in early 2017, in line with the forecasts reported in the *World Economic Situation and Prospects 2017*. World industrial production has seen an uptick in growth since November 2016, and forward-looking indicators point to further acceleration in the coming months. In tandem with the revival of production, global trade is recovering, reflecting a broad-based improvement in export performance across regions, driven primarily by rising import demand from East Asia. Confidence and economic sentiment indicators have also generally strengthened, especially in developed economies. World gross product is expected to expand by 2.7 per cent in 2017 and 2.9 per cent in 2018 (table), unchanged from the *World Economic Situation and Prospects 2017* forecasts released in January. While this marks a notable acceleration compared with growth of 2.3 per cent in 2016, it is not sufficient to signal the balanced and sustained revival of global demand that is needed to make rapid progress towards achieving the Sustainable Development Goals. Gross domestic product (GDP) per capita declined in four major developing regions in 2016, with negligible per capita growth anticipated in Central, Southern and West Africa in 2017-2018 (figure I).

Figure I
Average annual gross domestic product per capita growth in developing and transition economies



Source: United Nations Statistics Division, National Accounts Main Aggregates database; United Nations Population Division, *World Population Prospects*; and forecasts by the Department of Economic and Social Affairs.

2. Underpinning the global economic recovery is firmer growth in many developed economies, including upward revisions to prospects for the United States of America and Japan. Economies in transition are also generally on a stronger footing, reflecting the slight rise in the oil price and some adjustment in the production structures of energy exporters. East and South Asia remain the world's most dynamic regions, benefiting from robust domestic demand and supportive macroeconomic policies. However, the outlook for some developing regions has

deteriorated since January. The recoveries in Brazil and the Russian Federation are still incipient; growth remains largely subdued in Mexico, Saudi Arabia and South Africa; and economic activity is decelerating in Turkey. Prospects for Africa have been confronted by compounding headwinds, with the mild recovery of many global commodity prices more than offset by domestic and regional pressures, driven largely by conflict and the impact of weather-related shocks. Famine was declared in South Sudan in February 2017, and several other countries are also at high risk, as the world faces one of the most acute humanitarian crises in many decades.

3. A return to strong and balanced global growth may remain elusive for several more years without a revival of investment and productivity. Business investment in the United States and Japan showed some recovery towards the end of 2016. Nonetheless, a prolonged episode of weak investment growth has taken a toll on global productive capacity, and high levels of economic and policy uncertainty continue to weigh on investment decisions in many countries. Despite a recent pick-up, private investment growth in China continues to be restrained by excess capacity in several heavy industries and higher financing costs. Meanwhile, the lower level of commodity prices since mid-2014 has weighed on new investment in many countries, including Brazil, Chile, the Russian Federation and South Africa. In Nigeria, policy shifts leading to heightened financial market volatility have weighed on investor sentiment. Given the close linkages between demand, investment, trade and productivity, the extended episode of weak global investment may perpetuate the lacklustre economic performance, without concerted policy efforts to fill infrastructure gaps and speed the diffusion of innovation within and across countries.

Growth of world output, 2015-2018

	Annual percentage change				*Change from World Economic Situation and Prospects 2017 forecast*	
	2015	*2016[a]*	*2017[b]*	*2018[b]*	*2017*	*2018*
World	2.6	2.3	2.7	2.9	0.0	0.0
Developed economies	2.2	1.6	1.8	1.8	0.1	0.0
United States of America	2.6	1.6	2.1	2.1	0.2	0.1
Japan	1.2	1.0	1.1	0.9	0.2	0.0
European Union	2.2	1.9	1.7	1.7	-0.1	-0.1
EU-15	2.1	1.8	1.6	1.6	0.0	-0.1
EU-13	3.7	2.9	3.2	3.2	0.0	-0.1
Euro area	2.0	1.7	1.6	1.7	-0.1	0.0
Other developed countries	1.5	1.8	2.1	2.1	0.1	-0.1
Economies in transition	-2.3	0.4	1.8	2.0	0.4	0.0
South-Eastern Europe	2.0	2.7	3.1	3.2	0.0	-0.1
Commonwealth of Independent States and Georgia	-2.5	0.3	1.7	1.9	0.3	-0.1
Russian Federation	-3.0	-0.2	1.5	1.5	0.5	0.0
Developing economies	3.8	3.6	4.2	4.8	-0.2	0.1
Africa	3.0	1.6	2.9	3.6	-0.3	-0.2
North Africa	3.0	2.4	3.3	3.6	-0.2	0.0
East Africa	6.7	5.5	5.8	6.3	-0.2	0.0
Central Africa	1.5	1.0	2.5	3.4	-0.9	-0.8
West Africa	3.1	0.3	2.4	3.5	-0.7	-0.6

	Annual percentage change				Change from World Economic Situation and Prospects 2017 forecast	
	2015	2016[a]	2017[b]	2018[b]	2017	2018
Southern Africa	1.9	0.7	1.8	2.6	0.0	0.0
East and South Asia	5.8	5.9	5.8	5.9	-0.1	0.0
East Asia	5.7	5.6	5.6	5.6	0.0	0.0
China	6.9	6.7	6.5	6.5	0.0	0.0
South Asia	6.2	6.8	6.7	7.1	-0.2	0.2
India[c]	7.6	7.0	7.3	7.9	-0.4	0.3
Western Asia	2.7	2.2	2.1	2.9	-0.4	-0.1
Latin America and the Caribbean	-0.6	-1.3	1.1	2.5	-0.2	0.4
South America	-1.9	-2.6	0.6	2.6	-0.3	0.6
Brazil	-3.8	-3.6	0.1	2.6	-0.5	1.0
Mexico and Central America	2.9	2.5	2.3	2.2	0.0	0.0
Caribbean	4.0	1.6	2.5	2.8	-0.2	0.0
Least developed countries	3.5	4.3	4.7	5.3	-0.5	-0.2
Memorandum items:						
World trade[d]	2.8	1.9	2.8	3.2	0.1	-0.1
World output growth with purchasing power parity-based weights	3.2	3.0	3.4	3.7	-0.1	0.0

Source: Department of Economic and Social Affairs.

[a] Partly estimated.

[b] Forecast, based in part on Project LINK.

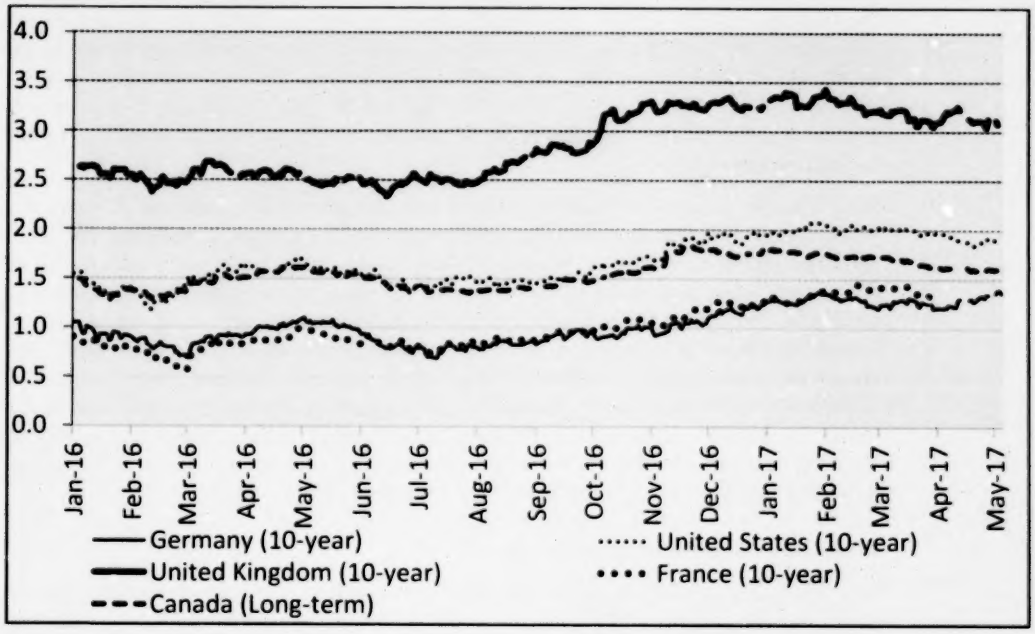
[c] Fiscal year basis.

[d] Includes goods and services.

4. The Federal Open Market Committee of the United States Federal Reserve raised the target range for the federal funds rate by 25 basis points in March, following a rise of the same magnitude in December 2016. With two further interest rate increases expected by the end of 2017, this marks the onset of a faster pace of interest rate hikes in the United States. This will lead to a widening divergence in global interest rates, with the European Central Bank and the Bank of Japan committed to maintaining ultra-low and negative interest rate policies for an extended period, and moves to lower interest rates in many commodity exporting countries as inflationary pressures ease.

5. Inflation dynamics in developed economies reached a turning point towards the end of 2016, leading the President of the European Central Bank to state in March 2017 that "the risks of deflation [in Europe] have largely disappeared", as the Bank slowed the pace of asset purchases. In Japan, inflation has edged above zero, while in the United States and the United Kingdom of Great Britain and Northern Ireland, headline inflation now exceeds 2 per cent. The upward trend in inflation rates has been largely driven by the rise in energy prices relative to the lows reached in early 2016. While this impact is likely to prove transitory, longer-term inflation expectations, as measured by the difference between nominal and inflation-indexed government bond yields, have risen by 0.3-0.4 percentage points since September 2016 in many developed economies (figure II), suggesting that higher levels of inflation may prove more persistent.

Figure II
Breakeven inflation rates from nominal and indexed government bond yields
(Percentage)



Source: Department of Economic and Social Affairs, based on data from Agence France Trésor, Bank of Canada, Bank of England, Bundesbank, German Ministry of Finance and United States Federal Reserve.

6. In many of the large emerging[1] markets, by contrast, price pressures have eased in recent months. Inflation has subsided to one of its lowest levels in more than 25 years in the Russian Federation, and is also low or subsiding in Latin America and in most countries of East and South Asia. Several commodity exporters in South America, parts of Africa and the Commonwealth of Independent States (CIS) cut interest rates in the early months of 2017, diverging from the interest rate path set by the United States. Food price inflation, on the other hand, stands at double-digit levels in 26 countries, of which 18 are in Africa, complicating the conduct of monetary policy. This has been driven largely by agricultural shortages caused by severe drought and other shocks related to El Niño, compounded by conflicts.

7. Fiscal policy is set to become more expansionary — or less restrictive — in many parts of the world. Significant tax cuts and an infrastructure investment programme are under discussion in the United States. Japan has introduced a fiscal stimulus package amounting to 28.1 trillion yen — the third-largest ever implemented. Canada has also introduced an expansionary policy. The stimulus measures in developed economies are largely geared towards infrastructure investment, after several years of steep cuts in government investment spending. Fiscal positions are also generally expansive in East Asia, including China. The rebound in commodity prices will also ease fiscal pressures in many commodity-

[1] The term "emerging economies" throughout the present report is not a formal definition, but refers to mainly middle-income developing and transition countries that are well integrated into the global financial system.

exporting countries, reducing short-term pressure to cut spending, although the longer-term need to diversify government revenue sources remains.

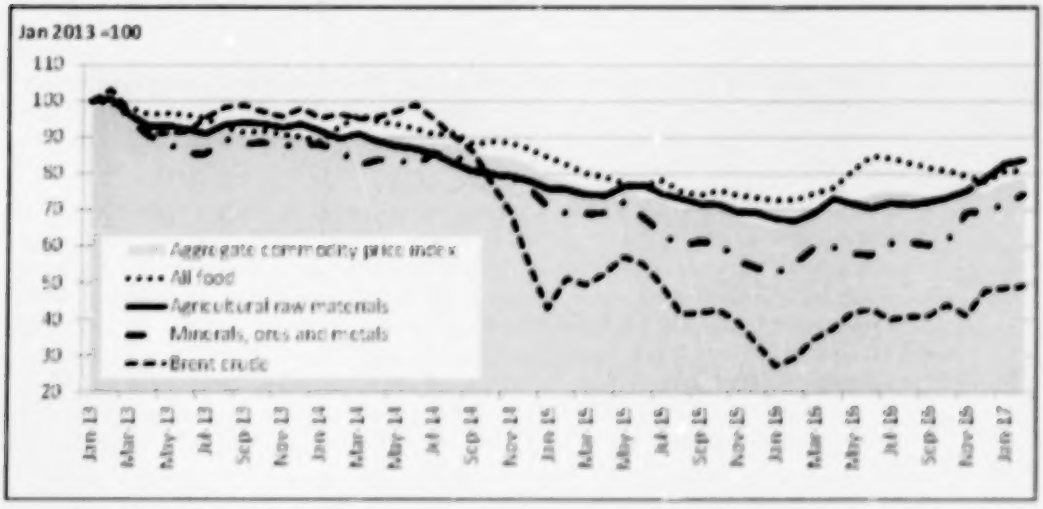
8. The rebound in confidence and economic sentiment indicators observed over the past several months in developed economies suggests that the perceptions of risks faced by households and firms have diminished. Nonetheless, news-based measures of uncertainty, such as the Global Economic Policy Uncertainty Index,[2] remain highly elevated, and the risks highlighted in *World Economic Situation and Prospects 2017* related to changes in the international policy environment continue to obscure the outlook.

9. The Government of the United States has introduced a wide range of measures since taking office in January. However, many policy proposals with the potential for large global economic spillovers — such as the renegotiation of trade deals and the introduction of a major fiscal stimulus — have yet to gain clarity. Similarly, while the time frame for the withdrawal of the United Kingdom from the European Union has been set, progress towards establishing a new framework for their economic relationship post-"Brexit" has yet to begin in earnest. There remains a significant risk that the expectations underpinning buoyant global economic sentiment may be disappointed, leading to a sharp reversal of confidence. Rising security concerns or the exposure of financial vulnerabilities in large emerging economies also have the potential to derail the modest recovery.

Trade flows and commodity prices

10. Many commodity-exporting countries experienced an improvement in terms of trade over the course of 2016, as commodity prices recovered from the lows reached in early 2016. Oil prices edged up further following agreements by the Russian Federation and the Organization of the Petroleum Exporting Countries (OPEC) to cut crude oil production in 2017. Nevertheless, given the high uncertainty in the global environment, oil spot prices will remain volatile, driven by rapid shifts in investor sentiment.

Figure III
Price indices of selected groups of commodities



Source: UNCTADstat.

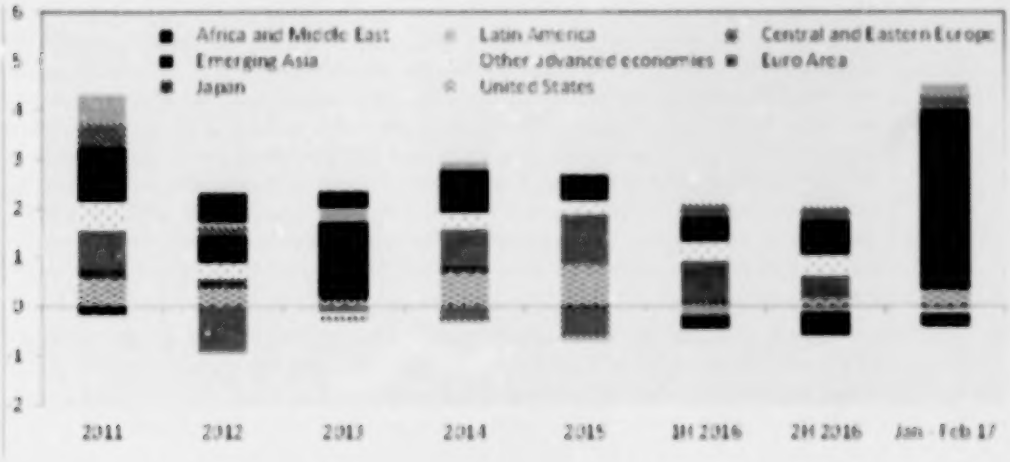
[2] See www.policyuncertainty.com/index.html.

11. Prices of many base metals, such as copper, zinc and nickel, have increased since November 2016, amid expectations of increased infrastructure spending in the United States and stronger-than-expected economic activity in China. The rise in metals prices is also attributable in part to production suspensions in key mining areas, such as nickel mines in the Philippines, copper mines in Chile and Indonesia, and zinc mines in Australia, so that the higher prices do not necessarily indicate higher revenues for all producing countries.

12. Since the final quarter of 2016, indicators such as export orders, international air freight volumes and global shipping costs have pointed to a modest recovery in global trade. Export volumes have picked up across both developed and developing regions, driven largely by stronger demand from emerging Asia (figure IV). However, longer-term trends related to changes in supply chains and slower progress in trade liberalization will restrain a rapid acceleration in world trade. Persistently high uncertainty may also weigh on trade activity, especially if recent trends towards a more restrictive global trade policy environment intensify. The volume of global trade in goods and services is forecast to increase by 2.8 per cent in 2017, following growth of 1.9 per cent in 2016.

Figure IV
Contribution to global import volume growth by region

(Percentage points)



Source: CPB Netherlands Bureau for Economic Policy Analysis.

Capital inflows and exchange rates

13. Capital flows to developing countries rebounded in early 2017, defying concerns over Federal Reserve interest rate hikes and the potential for significant shifts in international policy. Several large emerging economies, especially in Asia and Latin America, recorded strong increases in bond and equity inflows. In conjunction, most emerging market currencies strengthened against the dollar, recovering the losses incurred immediately after the elections in the United States.

14. The observed rebound in capital flows reflects increased optimism over growth prospects in some regions and rising risk appetite among investors amid persistently low yields in developed markets. Investors also appear less concerned about proposals for protectionist policies in the United States, despite potential costs that emerging market exporters may face.

15. Yet, the recent positive trends have taken place in the context of an overall weakness of capital flows to developing countries, which remain well below the levels seen in 2010-2014. Total net financial flows to developing economies were negative for the third consecutive year in 2016, owing in part to rapidly increasing outflows by resident investors in China. Consequently, policymakers in China announced temporary measures to mitigate the pace of capital outflows.

16. Total foreign direct investment (FDI) flows to developing economies fell by an estimated 20 per cent in 2016, as low commodity prices deterred investment in commodity-related sectors, compounding political uncertainty and rising security concerns in several economies. FDI flows to Africa, developing Asia and Latin America also continue to be heavily concentrated in a few large emerging economies. An increase in the value of announced greenfield projects, coupled with more supportive macroeconomic fundamentals, point towards a modest recovery in FDI flows to developing countries in 2017.

17. Despite the recent improvements, cross-border capital flows are susceptible to a deterioration in investor sentiment. Shifts in the international policy environment, rising concerns over financial vulnerabilities in China, political instability or reform setbacks in large emerging economies as well as escalating geopolitical tensions could lead to heightened investor risk aversion, triggering a new wave of capital reversals.

18. Significant uncertainties also loom over international currency markets. In the first weeks following the elections in the United States, the dollar reached its highest level since 2002, pushed up by the prospects of fiscal loosening in the country and a further divergence in monetary policies between the Federal Reserve and other major central banks. Subsequently, the dollar lost most of its post-election gains as investors became more cautious about the prospects for fiscal stimulus in the United States and somewhat more optimistic about the outlook in other major economies. Against the backdrop of a more benign financial environment, many developing economies and economies in transition have seen external and inflationary pressures moderate over the past six months, creating room for easier monetary policy.

19. Going forward, the continued widening of interest rate differentials will likely support the dollar against other developed and emerging currencies. While a strong dollar benefits exporters in many non-dollar-based economies, further appreciation poses a risk for countries that struggle with high dollar-denominated debt.

Poverty and inequality

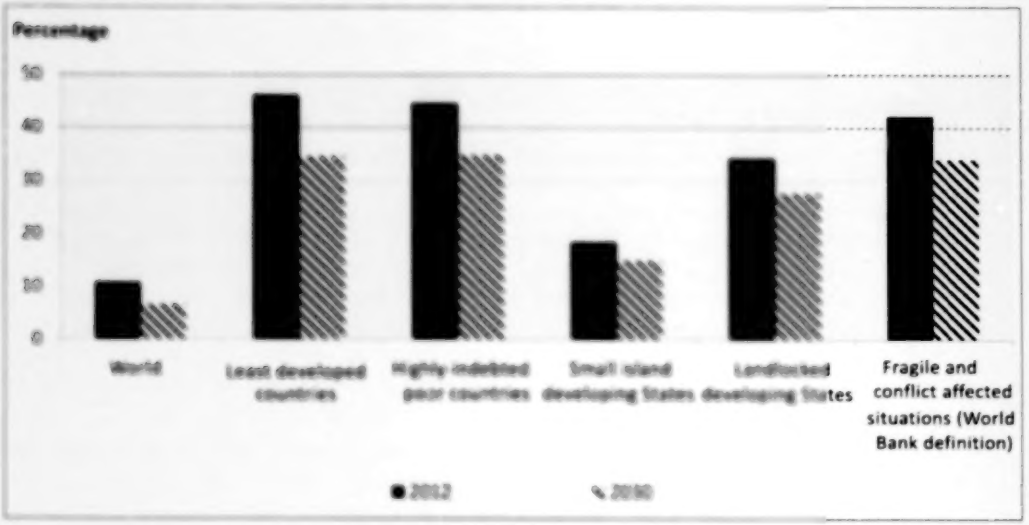
20. While prospects for GDP growth at the global level remain unchanged from *World Economic Situation and Prospects 2017*, the outlook for several of the least developed countries and countries where poverty levels remain high have deteriorated, raising concerns about both the short-term and longer-term prospects for addressing poverty and inequality. Of immediate concern, tens of millions face famine or severe food insecurity in parts of Kenya, north-east Nigeria, Somalia, South Sudan and Yemen, where widespread displacement and food supply blockages as the result of conflict are compounded by droughts that have destroyed crops and livestock. Other short-term concerns include the rise in food price inflation in many countries, which is likely to have a disproportionate impact on the poorest households, deepening inequalities within and between countries.

21. In the longer-term, tackling poverty requires both an acceleration in GDP growth and progress towards reducing income inequality. Figure V illustrates projections for poverty reduction by 2030, based on an extension of the baseline forecasts under the assumption that within-country income distributions remain

unchanged. The results paint a worrying picture. Without reducing income inequality, current growth projections would leave nearly 35 per cent of the population in least developed countries in extreme poverty by 2030.

Figure V

Extreme poverty headcount ratios in 2012 and projections for 2030, holding inequality constant



Source: Department of Economic and Social Affairs. See *World Economic Situation and Prospects 2017*.

22. Policymakers will need to make additional efforts, both to foster an environment that will accelerate medium-term growth prospects and to tackle poverty through policies that address inequalities in income and opportunity. The World Bank report[1] highlights selected policies that have been largely successful at reducing income inequality. These include short-term policies to smooth consumption among the most deprived, and longer-term policies that address inequalities in opportunity, such as investment in early childhood development, access to health care and education, and investment in rural roads and electrification.

Energy and environment

23. Global energy-related carbon emissions have stalled for three consecutive years in the context of expanding world output and low oil prices, marking a tentative step towards the delinking of emissions growth and global economic growth. Key factors behind this development include growing renewable power generation, improvements in energy efficiency, transition from coal to natural gas and decelerated economic growth in some major carbon emitters.

24. However, the improvements witnessed in recent years could easily reverse without concerted effort from the public and private sectors to improve energy efficiency and promote renewable energy. A return to stronger GDP growth may also result in higher levels of emissions, while low oil prices have the potential to derail efforts towards low-carbon transport, by deterring investment in technologies

[1] World Bank, *Poverty and Shared Prosperity 2016: Taking on Inequality* (Washington, D.C., 2016).

that compete with oil-based transportation, such as biofuels and electric vehicles, and reducing incentives to transition towards more fuel-efficient vehicles.

25. The reluctance of the Group of 20 (G-20) Finance Ministers and Central Bank Governors and the Group of Seven Energy Ministers to reaffirm the call for timely implementation of the Paris Agreement raises concerns about global commitments going forward, as does the current review of climate policies by the United States.

II. Economic outlook by regions

Developed economies

26. Economic activity in the United States accelerated in the second half of 2016, reflecting a strong rise in spending on consumer durables and residential investment, coupled with a turn in the inventory cycle as firms restocked depleted inventories. Investment in mining industries also rebounded in the final quarter, which may reflect the anticipated easing of environmental regulation and modest rise in the oil price. Economic activity in 2017 will gain some support from additional government spending. The Administration has requested a net increase in spending of $18 billion for the period up to September 2017. If approved, this will add 0.1 percentage points to growth, allowing GDP to expand by 2.1 per cent in 2017 and 2018.

27. The policy environment in the United States remains turbulent, as proposals by the Administration confront congressional and judicial hurdles. While the preliminary Budget Blueprint for the next financial year is budget neutral,[4] it excludes the infrastructure programme and tax cuts that are expected to be announced later in the year. These pose an upside risk to the current forecast. The Blueprint does detail proposed shifts in the composition of government spending, which includes a 10 per cent rise in spending on defence and border protection, offset by cuts in all areas of non-defence spending, including education, health care, environmental protection and development aid.

28. In Canada, uncertainty regarding United States trade policy has delayed a recovery in investment. Investment in 2017 will also be held back by the completion of the Hebron oil field platform, which has supported construction activity in the region for the past decade. Expansionary fiscal policy, on the other hand, will support economic activity in Canada, allowing GDP growth to accelerate to 2.2 per cent in 2017 and 2.3 per cent in 2018.

29. The macroeconomic policy stance in Japan remains highly accommodative, underpinning the forecast for GDP growth of 1.1 per cent in 2017. A significant rise in government investment is anticipated, as part of a 3 trillion yen (0.5 per cent of GDP) infrastructure investment programme. Private sector non-residential investment also showed signs of revival at the end of 2016 and may gain some near-term support in relation to the 2020 Olympic Games. With the population aged 15-64 declining at an average annual rate of 1 per cent, economic growth exceeds the expansion of capacity, and the output gap is positive. Nonetheless, inflation is unlikely to reach the central bank target of 2 per cent in 2017 or 2018. Nationwide consumer price inflation averaged -0.1 per cent in 2016, but rose to 0.3 per cent in early 2017, reflecting higher energy prices, depreciation of the yen and a tight labour market, with the unemployment rate hovering just below 3 per cent.

[4] Office of Management and Budget, *America First: A Budget Blueprint to Make America Great Again*, March 2017. Available from www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/2018_blueprint.pdf.

30. Growth in the European Union will remain robust at 1.7 per cent in 2017 and 2018, in line with the previous forecast. Private consumption has become a major driver behind this solid performance, reflecting improved labour market conditions, with a decline in the unemployment rate to 8.0 per cent in early 2017 and a solid pace in job creation. However, this aggregate number encompasses a wide range of national trends. Unemployment remains challengingly high in countries such as Greece and Spain, while labour markets in Czechia, Germany and some other countries exhibit signs of full employment and even labour shortages in certain areas.

31. On the business side, investment will also underpin solid growth, based on strong corporate profits and low interest rates. Nevertheless, the pace of investment will remain slower compared with previous periods, in view of heightened political and policy uncertainty. Continued robust intra-European Union demand will be a major component of growth, especially in the more export-dependent economies and sectors, such as machinery and automobiles. However, the heightened level of political and policy uncertainty, related to a number of national parliamentary elections, and the lack of clarity regarding the future framework for trade of the European Union with both the United Kingdom and, to some extent, also the United States, exposes Europe to a number of channels for possible negative growth shocks.

Economies in transition

32. Growth in the Commonwealth of Independent States and Georgia will accelerate to 1.7 per cent in 2017 and 1.9 per cent in 2018. The CIS energy-exporters will benefit from the recovery in oil prices. In the Russian Federation, the contraction in GDP by 0.2 per cent in 2016 was milder than anticipated, and GDP will expand by 1.5 per cent in 2017. Domestic demand has strengthened, but will remain a drag on growth, as consumption gains are limited, fiscal spending is declining in real terms, and investment is held back by uncertainties, economic sanctions and a weak banking sector. In Kazakhstan, a modest acceleration of growth is projected in 2017, supported by stimulus measures. To escape the low-growth trajectory, CIS energy-exporters need to pursue alternative development models independent of energy revenues.

33. Among the energy-importers, the economy of Ukraine has shown a tentative recovery in 2016, supported by an ample harvest and a surge in construction, but renewed internal instability in early 2017 stands to damage the key energy and steel sectors. In Belarus, weak domestic demand continues to dampen the recovery. Among the smaller economies, Armenia is suffering from a contracting construction sector. A stronger expansion is possible in Central Asia, supported by a rebound in remittances to Kyrgyzstan and Tajikistan and by deepening links with China. The CIS region is facing significant risks, including banking sector fragilities exacerbated by depreciations, external debt repayments and ongoing geopolitical tensions.

34. In South-Eastern Europe, aggregate GDP growth is expected to accelerate from 2.7 per cent in 2016 to 3.1 per cent in 2017 and 3.2 per cent in 2018. The region has received large FDI inflows in recent years and this is starting to be reflected in increased output capacity.

Developing countries

Asia

35. Following a slight growth moderation in 2016, East Asia is projected to expand at a steady pace of 5.6 per cent in both 2017 and 2018, in line with the

previous forecast. Growth in the region will continue to be driven by robust domestic demand, in particular private consumption and public investment. The region will also benefit from a recovery in exports, amid a gradual improvement in global and intra-regional demand. Despite supportive financial conditions in the region, private investment is likely to remain subdued amid heightened uncertainty.

36. Growth in China is projected to moderate from 6.7 per cent in 2016 to 6.5 per cent in 2017 and 2018. The stronger-than-expected growth in China in 2016 and in early 2017 was attributable in part to policy stimulus measures. While ongoing structural reform measures will continue to dampen investment in sectors with excess capacity, domestic demand will remain supported by accommodative fiscal measures. Nevertheless, increasing financial sector vulnerabilities, such as elevated corporate debt and property prices, are posing a growing policy challenge.

37. Most other economies in the region will see a pick-up in growth. Private consumption will remain the key driver of growth, amid rising incomes and modest inflationary pressures. Growth in Indonesia and Malaysia will be further lifted by higher commodity prices, while economic activity in the Philippines and Thailand will benefit from large public infrastructure spending.

38. Downside risks to the region's growth outlook have increased. A more restrictive global trade environment would adversely affect East Asia's overall growth prospects, given the region's high trade openness. In addition, a sharper-than-expected slowdown in China would have large spillover effects to the region through trade, financial and investment channels. For several economies in the region, high private sector debt continues to pose a risk to financial stability and growth. In this challenging environment, fiscal policy is likely to play a key role in boosting domestic demand and supporting the region's development priorities.

39. South Asia will see growth of 6.7 per cent in 2017 and 7.1 per cent in 2018, amid vigorous private consumption, domestic reforms and supportive macroeconomic policies. Despite temporary disruptions from the demonetization policy, economic conditions in India remain robust, underpinned by sound fiscal and monetary policies and the implementation of key domestic reforms. Yet, stressed balance sheets in the banking and corporate sectors will prevent a strong investment rebound in the near term. Growth in the Islamic Republic of Iran is strengthening, owing to increasing oil production and exports and rising private investment. Meanwhile, economic growth in Nepal and Maldives is expected to gain momentum, while Bangladesh, Bhutan and Pakistan are projected to maintain a moderately robust growth path. Regional inflation reached a multi-decade low last year and is projected to remain generally stable, providing space for accommodative monetary policy in most economies. Sri Lanka, is an exception, however, as inflationary pressures coupled with stubbornly high credit expansion have resulted in a tighter monetary stance.

40. In most economies, fiscal policy has remained moderately tight, but with some flexibility to boost public infrastructure. A key challenge is to improve fiscal revenues and the capacity to implement counter-cyclical policies, which requires a broadening of the tax base and improved tax compliance. Given the large infrastructure gaps, public investments should crowd-in private investments in areas such as energy, transport and water/sanitation. Domestic reform setbacks, heightened political instability and a sudden tightening of global financing conditions, however, pose downside risks. In addition, a surge in inflation can rapidly force a tighter monetary stance, dampening private consumption, as currently observed in Sri Lanka. The favourable regional outlook will be conducive for further improvements in the labour market and gains in poverty reduction.

41. Western Asia is forecast to see aggregate growth of 2.1 per cent in 2017 and 2.9 per cent in 2018. For 2017, this constitutes a significant downward revision from 2.5 per cent in *World Economic Situation and Prospects 2017*, owing mainly to weaker prospects in Turkey. Balance-of-payments pressures, after a substantial depreciation of the Turkish lira, are constraining domestic demand.

42. In view of the rising oil prices, cautious optimism emerged among the member States of the Gulf Cooperation Council, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. The broad money stock growth has been recovering in those countries after a significant plunge last year, indicating a moderate domestic demand expansion, amid stable financing costs. Fiscal consolidation efforts continue among member countries of the Council, including subsidy reforms, the privatization of State enterprises, and the planned introduction of the Gulf Cooperation Council unified value-added tax in 2018.

43. For Jordan and Lebanon, the outlook remains subdued owing to weak prospects for domestic demand. Both countries experienced rising inflation as the terms-of-trade advantage of weak commodity prices dissipated. Israel will continue to see robust growth, driven by a stable domestic demand expansion, with low inflation despite a tightening labour market. Humanitarian crises in Iraq, the Syrian Arab Republic and Yemen continue. While several signs of economic stabilization have started to emerge in Iraq, in Yemen an estimated 65 per cent of the population has been classified as food-insecure.

Africa

44. Growth in Africa remains subdued, owing to more severe headwinds than previously expected. Modest growth rates of 2.9 per cent and 3.6 per cent are expected in 2017 and 2018, respectively, down from forecasts of 3.2 per cent and 3.8 per cent in January.

45. Forecasts for 2017 were lowered in all subregions except Southern Africa, which is expected to benefit from the small recovery in commodity prices and a better harvest. However, tighter external financing conditions, currency depreciation and political instability could undermine prospects. In East Africa, growth will be driven by investment supported by government incentives, while current weather patterns will act as a significant drag on growth. Despite remaining the fastest growing African region, the situation of the poorest remains critical. In North Africa, the downward revision is driven primarily by rapid inflation in Egypt. Stronger growth is anticipated in 2018, as the stabilizing security situation and stronger demand from Europe should prompt a recovery in tourism and trade. The prospects for Central Africa remain subdued as a result of low oil revenues and political stability risks. Similarly, pressures on the oil sector and foreign exchange constraints keep growth prospects down in Nigeria and, consequently, West Africa.

46. Despite tight monetary stances, inflation will remain elevated, owing to gradually rising commodity prices, lagged effects of currency depreciations and dry weather in East Africa. High food inflation is particularly worrying, as it has a severe impact on the poor. Fiscal deficits remain stable but high, as a result of increases in infrastructure and social spending.

47. The outlook is subject to a number of risks. A more pronounced slowdown in China would negatively impact many economies that receive rising levels of FDI and investment finance from China. A sharper rise in global yields and a stronger United States dollar would deteriorate external financing conditions, offset slightly by increased remittances. Security issues and political instability also pose critical threats. More than 20 million people face starvation and famine in north-east Nigeria, Somalia and South Sudan as the result of drought and protracted conflicts.

Finally, should weather-related shocks continue, severe economic and social consequences are expected.

Latin America and the Caribbean

48. Following two years of negative GDP growth, Latin America and the Caribbean will see a modest economic recovery in 2017 and 2018. The region's GDP contracted by 1.3 per cent in 2016 amid deeper-than-expected recessions in Argentina, Brazil and the Bolivarian Republic of Venezuela. With Argentina and Brazil projected to recover gradually, regional growth is forecast at 1.1 per cent in 2017 and 2.5 per cent in 2018. The region continues to face significant uncertainties and risks, especially related to macroeconomic policy measures in the United States and domestic reform agendas.

49. South America is expected to see a broad-based, but slow recovery in growth. Lower inflation, easier monetary conditions and, in some cases, improved macroeconomic fundamentals will support private consumption and investment. Across the subregion, inflationary pressures have declined more rapidly than expected in recent quarters and currencies have remained firm, giving central banks room to reduce interest rates. South America's commodity exporters will likely benefit from stronger external demand and slightly higher commodity prices. Despite the expected improvement, several factors will weigh on the growth performance of South America during the forecast period, including elevated unemployment, the continuing need for fiscal consolidation, and structural obstacles, such as low productivity growth and a lack of economic diversification.

50. The outlook for Mexico and Central America has remained largely unchanged, with growth projected to barely exceed 2 per cent. In Mexico, private consumption and investment has so far shown resilience to a potential introduction of protectionist measures in the United States. While tighter monetary conditions and elevated uncertainty will weigh on economic activity in the coming quarters, annual growth is projected to slow only mildly. In the Caribbean, average GDP growth is likely to improve from the slow pace of 2016, when Cuba and Trinidad and Tobago registered economic contractions. The subregion continues to be characterized by stark differences in economic performance. The Dominican Republic is among the fastest-growing economies in Latin America and the Caribbean, whereas most of the smaller economies of the subregion remain on a low growth path.

Least developed countries

51. Economic prospects in many of the least developed countries have deteriorated since January 2017. GDP for this group as a whole is expected to rise by just 4.7 per cent in 2017 and 5.3 per cent in 2018, well below the Sustainable Development Goal target of "at least 7 per cent GDP growth". The rise in consumption per capita is expected to average just 1.7 per cent between 2016 and 2018, well below the pre-crisis average in the vast majority of countries. The economic slowdown, compounding widespread institutional deficiencies, poses a risk to critical efforts to support health care, education, social protection and adapting to climate change, and points to slower progress towards improving living standards and tackling widespread poverty.

III. Major uncertainties and risks to the global economy

52. The risks to the baseline forecasts discussed in section I are tilted to the downside. Persistently high policy uncertainty is likely to prevent a strong rebound in private investment globally. Amid widening interest rate differentials in

developed countries, financial markets remain vulnerable to bouts of heightened risk aversion, triggered by sudden policy shifts, unexpected economic data, as well as an escalation in geopolitical tensions. In the developed economies, while business sentiments have risen and stock markets have been buoyant, it remains to be seen whether these financial trends will translate into stronger real economic activity, in particular a sustained revival of private investment.

Changes in the international policy environment

53. As highlighted in the *World Economic Situation and Prospects 2017*, the shifting international policy landscape has generated large and widespread global uncertainty in the areas of trade, immigration and environment. Rising discontent with the uneven burdens and gains of globalization has in part fuelled more protectionist and inward-looking views in some developed economies. This is also increasingly undermining multilateral engagements and international cooperation and coordination in several domains. The rapid evolution in the international policy environment has the potential to considerably impact the growth trajectory of the global economy, while affecting progress on the various social and environmental aspects of the Sustainable Development Goals.

54. The decision by the United Kingdom to leave the European Union is one source of policy uncertainty. In March 2017, the United Kingdom triggered article 50 of the Treaty of Lisbon, formally starting the process of leaving the European Union. Exiting from the European Union requires a comprehensive reconstitution of a host of relationships, including trade, financial and migration arrangements between the United Kingdom and the European Union as well as between the United Kingdom and other partners whose relationship with the United Kingdom is currently covered by European Union treaties. Against this backdrop, the United Kingdom faces the prospect of higher trade barriers in its future trade with the European Union, for example in terms of technical and administrative regulations. There is also considerable uncertainty over whether the redefined trade and investment policies of the United Kingdom may limit market access for developing countries. This may have negative implications on the growth and development prospects of countries with high dependence on exports to the United Kingdom.

55. A resurgence of trade protectionism constitutes a key downside risk to the global outlook. In March, the statement by the G-20 Finance Ministers did not reaffirm a commitment to "resist all forms of protectionism" for the first time in 10 years. Meanwhile, the latest World Trade Organization (WTO) *Trade Monitoring Report* noted that the overall stock of trade-restrictive measures continued to trend upwards in 2016, owing to a slow rollback of existing measures and a relatively rapid introduction of new restrictive measures, mainly non-tariff barriers. The shifting policy landscape in the United States and in parts of Europe also points to a rise of unilateral protectionist tendencies in some developed countries. An increasingly restrictive global trade policy environment will slow progress towards the Sustainable Development Goals, given the close linkages between trade, productivity and income growth.[5] Reducing restrictions to trade in services would also contribute towards raising export capacity, increasing productivity and encouraging structural transformation consistent with development objectives.

56. The United States has announced a sweeping review of its existing trade relationships. The new Administration withdrew the United States from the Trans-

[5] World Bank, *Making trade an engine of growth for all: the case for trade and for policies to facilitate adjustment*, Washington, D.C. 2017. Available from http://documents.worldbank.org/curated/en/318651491579082111/Making-trade-an-engine-of-growth-for-all-the-case-for-trade-and-for-policies-to-facilitate-adjustment.

Pacific Strategic Economic Partnership Agreement, has also announced its intention to renegotiate other major trade agreements, and put forward proposals to impose ad hoc import tariffs on goods from certain locations, which could trigger legal action before WTO and spur retaliatory effects. This would be particularly detrimental for the trade outlook of countries where the United States is a major export destination, including Canada, China and Mexico. Furthermore, there will also be considerable spillover effects to countries where global and regional value chains are prevalent, such as the developing economies of Asia.

57. The policy agenda in the United States also encompasses some upside potential, which may have positive global spillovers. A more expansionary fiscal policy, with an emphasis on infrastructure, and tax reform measures, including lower corporate taxes, could raise private investment and output, at least in the short term. Nevertheless, these initiatives are still in early stages and there are widespread uncertainties regarding their timing and nature, particularly with respect to fiscal sustainability considerations. The current Administration has also announced plans to ease financial regulations, particularly the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. However, while there is scope for simplification and efficiency gains in this area, major policy shifts towards deregulating the financial sector entail non-trivial, medium-term financial risks for the global economy. Also, some of these policies might strengthen the value of the dollar further, which, coupled with rising interest rates, can deepen the vulnerabilities of emerging economies, as discussed in the next section.

Monetary tightening in the United States and vulnerabilities in emerging economies

58. Following almost a decade of extremely loose monetary policy, the Federal Reserve is embarking on an accelerated pace of interest rate rises. As interest rates normalize, the Federal Reserve will look to begin unwinding the post-crisis quantitative easing that more than quadrupled the size of its balance sheet between 2008 and 2014. In the outlook period, this major policy shift may pose significant challenges to the global economy and financial markets. The timing of interest rate hikes is uncertain, with the potential for stronger growth and higher inflationary pressures to lead to a faster-than-expected pace. Coordinating the normalization of policy rates with the normalization of the Federal Reserve balance sheet poses a number of challenges, with significant potential for maturity or liquidity mismatches to disrupt financial markets. Meanwhile, many emerging economies remain highly vulnerable to external and domestic shocks, amid relatively low commodity prices, structural weaknesses and political uncertainty.

59. Against this backdrop, the ongoing monetary tightening in the United States encompasses significant financial and economic risks for the emerging economies. A faster-than-expected rise in interest rates, especially if accompanied by a spike in risk aversion, could generate significant global financial volatility. Amid tighter global financial conditions, a sudden surge in capital outflows from the emerging economies would adversely impact equity prices and currencies, while significantly raising external borrowing costs and reducing monetary policy space. Recent evidence suggests that macroeconomic fundamentals in emerging economies tend to provide little insulation to sudden changes in financing conditions, and that real economy effects from "sudden stops" episodes have not declined in recent years.[6] The emerging economies with high borrowing needs, large dollar-denominated debt

[6] Barry Eichengreen and Poonam Gupta, "Managing sudden stops", Policy Research Working Paper, No. 7639 (Washington, D.C., World Bank, April 2016).

and fragile macroeconomic conditions will be the most susceptible to large and potentially destabilizing capital outflows.

60. The corporate sectors in emerging economies are especially vulnerable to sudden changes in financial conditions. Corporate debt in emerging economies has risen by more than four times in the past decade,[7] particularly in Brazil, China, the Russian Federation and Turkey, and the debt service-to-income ratio of the private non-financial sector has also visibly increased.[8] Corporate borrowing in global dollar bond markets has expanded rapidly, fuelled by a remarkably long period of low long-term interest rates and offshore borrowing by large emerging market firms through their subsidiaries abroad. Corporate debt in foreign currency has increased not only in the tradable sector, but also in non-tradable sectors, such as construction and real estate, where currency mismatch problems pose more of a risk.[9] The "financialization" of the corporate sector in emerging economies in order to exploit carry trade opportunities is another source of fragility. A significant part of the corporate debt of emerging markets was channelled neither to productive investments nor to high-productivity sectors, highlighting a misallocation of resources that casts a shadow over debt sustainability. Likewise, in China a large portion of credit has been channelled to less-efficient State-owned enterprises and local governments. As a result, the corporate sector in the emerging economies has become more vulnerable to interest rates shocks, which could be amplified by a decline in commodity prices, a further strengthening of the dollar or moves to sideline or dismantle multilateral agreements.

61. There are, however, several factors that may assist emerging economies to navigate tighter global financial conditions. In response to lower commodity prices and capital flows, several emerging economies have already experienced large macroeconomic adjustments in recent years. Current accounts deficits have narrowed visibly in Brazil, India and South Africa, and some countries have undergone significant corporate deleveraging, in particular the Russian Federation. In economies where real interest rates remain high, such as China, the authorities have some monetary policy space available to support growth. Greater exchange rate flexibility, improved net international investment positions and, in many cases, enhanced policy frameworks in comparison to previous decades, have facilitated this adjustment. From a medium-term perspective, growth prospects in many emerging economies remain largely favourable. Finally, emerging economies are also more prepared than decades ago to utilize a wider policy toolkit to manage external shocks, including through the use of monetary, fiscal, exchange rate and macroprudential policies.

IV. Policy challenges

62. Waning global commitments to international policy coordination, rising corporate sector vulnerabilities and ambitious medium-term targets for economic, social and environmental development in the 2030 Agenda for Sustainable Development pose significant global policy challenges.

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[7] International Monetary Fund, *Vulnerabilities, Legacies, and Policy Challenges: Risks Rotating to Emerging Markets, Global Financial Stability Report*, October 2015.

[8] United Nations Conference on Trade and Development, *Trade and Development Report, 2016* (United Nations publication, Sales No. E.16.II.D.5).

[9] Michael Chui and others, "A new dimension to currency mismatches in the emerging markets: nonfinancial companies", Bank for International Settlements Working Papers No. 550 (March 2016).

63. In the aftermath of the global financial crisis, an excessive emphasis was put on monetary policy alone to manage the deficiencies in aggregate demand. While this played an important role in economic stabilization, a consensus has emerged over the past several years that a more balanced policy mix is needed to achieve a higher medium- and long-term sustainable growth rate, to address poverty and inequality and to fight the damaging consequences of climate change. This policy toolkit may encompass a more effective use of fiscal policy, but also requires a move beyond policies of demand management to tackle structural issues. For example, reforms to the business environment may streamline administrative procedures and protect property rights; active industrial policies may be used to remedy market failures and encourage innovation and the absorption of new technologies; income policies could address poverty and widen access to social protection; investing in education, health, infrastructure and green technology would encourage progress towards social and environmental goals, while supporting economic growth; and regulatory reform could be designed to minimize financial risks, while ensuring funding for small and medium-sized businesses.

64. In the light of the rising corporate sector vulnerabilities in many emerging economies, it is also important to closely monitor the expansion of credit. In cases where rising levels of debt are not matched by a commensurate increase in productive investment or where currency mismatches are pervasive, targeted prudential measures are needed. Where macroeconomic fundamentals have strengthened, policy measures should refocus from short-term stimulus to tackling longer-term potential. Many developing countries need much higher investment rates, as well as higher labour force participation rates, especially where the participation of women in the workforce remains low, to move to a higher growth trajectory.

65. Global commitments to international policy coordination appear to be waning. In the face of pressing global challenges, it is crucial that the international community reaffirms these commitments, to tackle key areas of global importance, including aligning the multilateral trading system with the 2030 Agenda for Sustainable Development, expanding international public finance and official development assistance (ODA), supporting climate finance and clean technology transfer, and coordinating policy to address the challenges posed by large movements of refugees and migrants.

66. International trade, supported by a universal, rules-based, open, non-discriminatory and equitable multilateral trading system, has been a key factor driving economic growth in both developed and developing economies. While more open trade has in some cases been associated with job losses and declining wages for certain categories of workers, aligning the multilateral trading system with the 2030 Agenda for Sustainable Development has the potential to speed the rate of technological diffusion between countries and improve the efficiency of resource allocation, supporting jobs on both sides of the trading relationship. The replacement of multilateral rules with a network of bilateral agreements would have a negative impact on development prospects in many developing economies. A renewed commitment to multilateralism in international trade during the G-20 summit, to be held in Hamburg, Germany, in July 2017, and at the Eleventh WTO Ministerial Conference, to be held in Buenos Aires in December 2017, would offer clear signals.

67. International development aid has declined as a share of GDP since the global financial crisis, and ODA continues to fall well short of the commitment, reaffirmed by developed countries in the 2030 Agenda, to provide aid equivalent to 0.7 per cent of gross national income. The level of net ODA flows to least developed countries in United States dollar terms has declined by more than 10 per cent since 2011,

which is of particular concern in the light of the slowdown in growth prospects for several countries and the urgent investment needs to achieve the Sustainable Development Goals. International cooperation to ensure that aid budgets are not only maintained but increased is essential, as well as ensuring that aid is directed towards countries with the greatest needs, rather than used as a political tool to target countries on the basis of their strategic importance.

68. Renewed international cooperation is also needed in the area of managing the flow of refugees and displaced persons, which poses a significant challenge for many countries. The inflow of migrants and refugees places enormous pressure on institutional capacities in destination and transit countries, often affecting their own social and economic cohesion and development. To address these challenges, Member States are aiming to achieve both a global compact on refugees and a global compact for safe, orderly and regular migration in 2018, to be elaborated through a process of intergovernmental negotiations. This will require an intense cooperation among countries, and the active involvement of the United Nations development system and international financial institutions, to achieve tangible results in addressing the gaps in available funding, technical cooperation, data collection and information exchange, the provision of emergency relief assistance, and other key areas.